

**CLARENDON NATIONAL INSURANCE COMPANY
224 WEST STATE STREET
TRENTON, NEW JERSEY 08608**

NAIC COMPANY CODE 20532

MARKET CONDUCT EXAMINATION REPORT

As of December 31, 2004

**PREPARED BY INDEPENDENT CONTRACTORS FOR THE
COLORADO DEPARTMENT OF REGULATORY AGENCIES
DIVISION OF INSURANCE**

**Clarendon National Insurance Company
224 West State Street
Trenton, New Jersey 08608**

**MARKET CONDUCT
EXAMINATION REPORT**

**Workers' Compensation
As of
December 31, 2004**

Prepared by

Kathleen M. Bergan, AIE

Wayne C. Stephens, CIE, CPCU

Independent Contract Examiners

July 14, 2005

The Honorable David F. Rivera
Commissioner of Insurance
State of Colorado
1560 Broadway Suite 850
Denver, Colorado 80202

Commissioner Rivera:

In accordance with §§ 10-1-203 and 10-3-1106, C.R.S., an examination of selected underwriting, rating, and unit statistical report practices of Clarendon National Insurance Company's workers' compensation insurance business, has been conducted. The Company's records were examined at a Company owned third party administrator's office, North American Risk Services, located at 2600 Westhall Lane, Suite 400, Maitland, Florida, 32751. The Company's Administrative office is located at 7 Times Square, New York, NY 10036.

The examination covered the two and one-half year period from July 1, 2002 to December 31, 2004.

The report of the examination of Clarendon National Insurance Company is, herewith, respectfully submitted.

Kathleen M. Bergan, AIE

Wayne C. Stephens, CIE, CPCU

Independent Market Conduct Examiners

**MARKET CONDUCT EXAMINATION REPORT
OF THE
CLARENDON NATIONAL INSURANCE COMPANY**

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COMPANY PROFILE

Clarendon National Insurance Company (herein after referred to as “the Company”) was originally incorporated as Cavalier Insurance Corporation. On September 30, 1985, Clarendon America Insurance Company acquired Cavalier and was renamed Clarendon National Insurance Company. On February 25, 1999, the Company was purchased by Hannover Re, a German Corporation. Other insurance companies included in this group are: Clarendon Select Insurance Company, Harbor Specialty Insurance Company, Redland Insurance Company, and Insurance Corporation of Hannover.

The Company writes primarily homeowners, workers’ compensation, personal auto, commercial auto, and commercial general liability insurance, and operates as a program writer through general agents.

The Company was licensed in Colorado in 1986, and is licensed to do business in all fifty (50) states.

Effective May 1, 2001 Clarendon contracted with Fremont General Insurance Agency, Inc. to issue workers' compensation policies for Clarendon National Insurance Company and for Harbor Specialty Insurance Company, and to handle claims under those policies. Effective May 1, 2001 Clarendon contracted with Fremont Indemnity Company to reinsure policies written under the agreement.

This agreement to grant authority to produce, bind, quote or renew policies issued on business located in the State of Colorado terminated effective January 31, 2004, after which policies were written in Employers Insurance Company of Nevada as they expired in Clarendon.

The Company’s workers’ compensation direct written premium in 2003 was \$4,801,000 with a .55% market share. In 2004 the direct written premium dropped to \$844,804. This was the result of the termination of the general agency agreement as described above.

PURPOSE AND SCOPE OF EXAMINATION

This market conduct report was prepared by independent examiners contracting with the Colorado Division of Insurance for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the State of Colorado. This procedure is in accordance with Colorado Insurance Law §10-1-204, C.R.S., which empowers the Commissioner to supplement his resources to conduct market conduct examinations. The findings in this report, including all work product developed in the production of this report, are the sole property of the Colorado Division of Insurance.

The purpose of this examination was to determine the Company's compliance with Colorado insurance laws and with generally accepted operating principles related to workers' compensation. Examination information contained in this report should serve only those purposes. The conclusions and findings of this examination report are public record. The preceding statements are not intended to limit or restrict the distribution of this report.

This examination was governed by, and performed in accordance with, procedures developed by the National Association of Insurance Commissioners, the Colorado Division of Insurance and the Insurance Regulatory Examiners Society. In reviewing material for this report, the examiners relied primarily on records and materials maintained by the Company. The examination period covered two and one-half years of the Company's operations, from July 1, 2002 to December 31, 2004.

File sampling was based on a review of underwriting and claims files that were randomly selected by using ACL™ software and computer data files provided by the company. Sample sizes were chosen based on procedures developed by the National Association of Insurance Commissioners. Upon review of each file, any concerns or discrepancies were noted on comment forms and delivered to the Company for review. Once the Company was advised of a finding contained in a comment form, the Company had the opportunity to respond. For each finding the Company was requested to agree, disagree or otherwise justify the Company's noted action. At the conclusion of each sample the Company was provided a summary of the findings for that sample. The examination report is a report by exception. Therefore, much of the material reviewed is not addressed in this written report. Reference to any practices, procedures, or files, which manifested no improprieties, was omitted.

When sampling was involved, a minimum error tolerance level of five percent (5%) was established to determine reportable exceptions. However, if an issue appeared to be systematic or when due to sampling process it was not feasible to establish an exception percentage, a minimum error tolerance percentage was not utilized. Also, if more than one sample was reviewed in a particular area of examination (e.g. classification of employees), and if one or more samples yielded an exception rate of five percent (5%) or more, the results of any other samples with exception percentages less than five (5%) were also included.

An error tolerance level of plus or minus ten dollars (\$10.00) was allowed in most cases where monetary values were involved. However, in cases where monetary values were generated by computer or other systemic methodology, a zero (\$0) tolerance level was applied in order to identify possible system errors. Additionally, a zero (\$0) tolerance level was applied in instances where there appeared to be a consistent pattern of deviation from the Company's established policies, procedures, rules and/or guidelines.

The examination of Workers' Compensation included the following reviews:

- A. Policies with Experience Modifiers
- B. Policies without Experience Modifiers
- C. 2004 Policies
- D. Unit Statistical Plan Reporting
 - 1. Premium Audits
 - 2. Claims Comparison
 - a. Policies with Experience Modifiers

There were no deductible policies with claims on the data list provided by the Company.

Certain unacceptable or non-complying practices may not have been discovered in the course of this examination. Additionally, findings may not be material to all areas that would serve to assist the Commissioner. Failure to identify or criticize specific Company practices does not constitute acceptance by the Colorado Division of Insurance. Examination findings may result in administrative action by the Division of Insurance.

EXAMINERS' METHODOLOGY

The examiners reviewed the Company's Workers' Compensation policies, audits, billings and Unit Statistical reporting practices to determine compliance with NCCI Manual Rules and Colorado insurance laws as outlined in Exhibit 1.

Below are the Workers' Compensation Laws and Regulations applicable during the period under review.

Law	Subject
Section 10-4-110	Notice of intent prior to nonrenewal of certain policies of insurance.
Section 10-4-110.5	Notice of intent prior to unilateral increase in premium or decrease in coverage previously provided of certain policies of insurance.
Section 10-4-113	Exemptions.
Section 10-4-401	Purpose – applicability.
Section 10-4-413	Records required to be maintained.
Section 10-4-416	Prohibiting changes in rates or coverages.
Section 10-4-421	Notice of rate increases and decreases.
Regulation 1-1-7	Market Conduct Record Retention
Regulation 1-1-8	Penalties And Timelines Concerning Division Inquiries And Document Requests.
Regulation 5-1-10	Rate and Rule Filing Submissions
Regulation 5-1-11	Risk Modification Plans
Regulation 5-3-1	Workers' Compensation Risk Management Regulation
Regulation 5-3-2	Workers' Compensation Insurance Data Reporting Regulation
Regulation 5-3-3	Concerning Workers' Compensation Deductible Policies in Excess of \$5,000
Regulation 5-3-4	Concerning Standards for Not-At-Fault Motor Vehicle Accidents Under Workers' Compensation, Loss Limitation in Calculating Experience Modifications and Distribution of Losses in Excess of The Loss Limitation
Regulation 5-3-5	Workers' Compensation Deductible Reimbursement
Regulation 6-2-2	Response to Division Inquiries Concerning Complaints

Company Operations/Management

The examiners reviewed Company management, implementation and quality controls, record retention and timely cooperation with the examination process.

Contract Forms and Endorsements

Forms and endorsements used by the Company in writing Workers' Compensation policies containing Colorado exposures are filed with the Colorado Division of Insurance by the National Council on Compensation Insurance and no review was conducted of these forms.

Audited Policies

For the period under examination, the examiners randomly selected the following underwriting samples to determine compliance with underwriting and rating requirements:

Underwriting Lists July 1, 2002 – December 31, 2003	Population	Sample Size	Percentage to Population
Policies with Experience Modifiers	326	50	15%
Policies without Experience Modifiers	502	50	10%
Cancelled Policies	227	50	22%
January 1, 2004 – December 31, 2004			
All 2004 Policies	30	30	100%

Rating

Workers' Compensation rate and rule filings, statistical justifications, and methodology submitted to Colorado Division of Insurance were reviewed for the period under examination. This information was then compared against samples of policies with experience modifiers and policies without experience modifiers to determine compliance with NCCI filed loss costs factors, Company filed loss cost multipliers, schedule rating and payroll information. In addition, a review was performed on compliance with NCCI promulgated experience modifiers and NCCI manual rules concerning proper employee classifications, officer payrolls, fixed premium determinations for officers, partners or sole proprietors and proper calculation of terrorist coverage premiums. In addition, there was a review of compliance with Colorado cost containment, designated medical provider and deductible disclosure requirements.

Unit Statistical Reports

For the period under examination, the Company reported there were no deductible policies with claims.

The audited and billed policies with experience modifiers were compared to the audit and premium information on the Unit Statistical Reports to verify the information was transmitted correctly to the NCCI.

**Workers' Compensation Unit Statistical Reports
July 1, 2002-December 31, 2003**

Claims List	Population	Sample Size	Percentage to Population
Claims from Policies with Experience Modifiers	61	61	100%

The maximum number of claims examined from any policy's statistical report is normally twenty-five (25) but there were no policies with more than this number in this review.

EXAMINATION REPORT SUMMARY

The examination resulted in six (6) issues arising from the Company's apparent failure to comply with Colorado insurance laws that govern all property and casualty insurers operating in Colorado. These issues involved the following categories:

Company Operations and Management:

In the area of company operations and management, there are two (2) Compliance issues addressed in this report. In regard to these Company Operation and Management practices, it is recommended that the Company review its procedures and make the necessary changes to assure future compliance with applicable Colorado insurance laws.

The issues in this phase of the examination are as follows:

- Failure of the Company, in some cases, to maintain records required when writing workers' compensation policies with Colorado exposure.
- Failure of the Company, in some cases, to provide documents in a timely manner to complete the review of workers' compensation claim payments, reserves, audit worksheets and billing statements in order to compare to the Unit Statistical Reports and ascertain correctness of billing factors.

Underwriting and Rating:

In the area of underwriting and rating, four (4) compliance issues are addressed in this report. An issue may arise from Colorado insurance law requirements that must be complied with whenever policies are issued to Colorado insureds or containing Colorado exposures. In regard to these underwriting and rating practices, it is recommended that the Company review its underwriting and rating procedures and make the necessary changes to assure future compliance with applicable Colorado insurance laws.

The issues in this phase of the examination are identified as follows:

- Failure of the Company to require the insured to indicate on a form their awareness of the premium differential available when an insured selects a medical cost containment option and a designated medical provider and to retain this form in the insured's underwriting file.
- Failure of the Company, in some cases, to apply the correct rating methodology when rating and/or auditing workers' compensation policies with Colorado exposures.
- Failure of the Company, in some cases, to audit the insured's records in order to calculate a correct earned premium for the Workers' Compensation Policy.
- Failure of the Company, in some cases, to clearly and conspicuously inform the policyholders of the availability of the deductible options as specified in the NCCI Colorado manual rules.

NCCI Unit Statistical Reports

Issues can result from failure to follow Colorado statutory and regulatory requirements and the requirements of the NCCI when reporting policy and claim information to the NCCI.

There were no issues in this phase of the examination.

A copy of the Company's response, if applicable, can be obtained by contacting the Company or the Colorado Division of Insurance.

Results of Market Conduct Exams are available on the Colorado Division of Insurance's website at www.dora.state.co.us/insurance or by contacting the Colorado Division of Insurance.

MARKET CONDUCT EXAMINATION REPORT

PERTINENT FACTUAL FINDINGS

CLARENDON NATIONAL INSURANCE COMPANY

COMPANY OPERATIONS AND MANAGEMENT

PERTENENT FACTUAL FINDINGS

Issue A: Failure of the Company, in some cases, to maintain records required when writing workers' compensation policies which contain Colorado exposures.

Section 10-4-413, C.R.S., Records required to be maintained, states in part:

(1) Every insurer...shall maintain reasonable records, of the type and kind reasonably adapted to its method of operation, of its experience or the experience of its members and of the data, statistics, or information collected or used by it in connection with the rates, rating plans, rating systems, underwriting rules, policy or bond forms, surveys, or inspections made or used by it, so that such records will be available at all reasonable times to enable the commissioner to determine whether such organization, insurer, group, or association and, in the case of an insurer or rating organization, every rate, rating plan, and rating system made or used by it complies with the provisions of this part 4 applicable to it...*Such records shall be maintained in an office within this state or shall be made available for examination or inspection by the commissioner at any time, upon reasonable notice.* [emphasis added]

Colorado Regulation 1-1-7, Market Conduct Record Retention, promulgated under the authority of Section 10-1-109, C.R.S., states, in part:

(B) RECORDS REQUIRED FOR MARKET CONDUCT PURPOSES

1. Every insurer/carrier or related entity licensed to do business in this state shall maintain its books, records, documents and other business records so that the insurer's/carrier's or related entity's claims, rating, underwriting, marketing, complaint, and producer licensing records are readily available to the Commissioner. Unless otherwise stated within this regulation, records shall be maintained for the current calendar year plus two calendar years.
2. A policy record shall be maintained for each policy issued in this state. Policy records shall be maintained for the current policy term, plus two calendar years, unless otherwise contractually required to be retained for a longer period. Provided, however, documents from policy records no longer required to be maintained under this regulation, which are used to rate or underwrite a current policy, must be maintained in the current policy records. Policy records shall be maintained so as to show clearly the policy term, basis for rating and, if terminated, return premium amounts, if any. Policy records need not be segregated from the policy records of other states so long as they are readily available to the commissioner as required under this rule. A separate copy need not be maintained in the individual policy records, provided that any data relating to that policy can be retrieved. Policy records shall include:
 - a. The application for each policy, if any;
 - b. Declaration pages, endorsements, riders, termination notices, guidelines or manuals associated with or used for the rating or underwriting of the policy. Binder(s) shall be retained if a policy was not issued; and
 - c. Other information necessary for reconstruction of the rating and underwriting of the policy.

The following charts illustrate the significance of errors versus the population and sample examined:

**Workers' Compensation Policies with Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
326	50	6	12%

An examination of fifty (50) policies with experience modifiers, representing 15% of all workers' compensation policies with experience modifiers which contain Colorado exposures written by the Company during the period July 1, 2002 to December 31, 2003, showed six (6) exceptions in which the files did not contain the required signed exclusion or inclusion forms.

**Workers' Compensation Policies without Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
502	50	14	28%

An examination of fifty (50) policies without experience modifiers, representing 10% of all workers' compensation policies without experience modifiers which contain Colorado exposures written by the Company during the period July 1, 2002 to December 31, 2003, showed fourteen (14) exceptions in which the files did not contain the required signed exclusion or inclusion forms

**Workers' Compensation Policies with 2004 Inception Dates
From January 1, 2004-December 31, 2004**

Population	Sample Size	Number of Exceptions	Percentage to Sample
30	30	7	23%

An examination of thirty (30) policies with inception dates in 2004, representing 100% of all workers' compensation policies which contain Colorado exposures written by the Company during the period January 1, 2004 to December 31, 2004, showed seven (7) exceptions in which the files did not contain the required signed exclusion or inclusion forms

Recommendation Number 1:

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Section 10-4-413, C.R.S. and Colorado Regulations 1-1-7. If the Company is unable to provide such documentation, it should be required to provide written evidence to the Colorado Division of Insurance that it will maintain required records, when writing workers' compensation policies containing Colorado exposures in compliance with Colorado insurance laws.

Issue B: Failure of the Company, in some cases, to provide documents in a timely manner to complete the review of workers' compensation claims payments, reserves, audit worksheets and billing statements, in order to compare to the Unit Statistical Reports and ascertain correctness of billing factors.

Regulation 1-1-8, Penalties And Timelines Concerning Division Inquiries And Document Requests, promulgated pursuant to §§ 10-1-109, 10-2-104, 10-3-109(3), and 10-16-109, C.R.S., states:

Section 2 Background And Purpose

The purpose of this regulation is to prescribe the time period in which all persons and entities shall respond to Division inquiries, including, but not limited to, document and information requests during market conduct and financial examinations, investigations of complaints, and any other formal or informal investigation or examination conducted for the purpose of determining compliance with Colorado insurance law. In addition, the purpose of this regulation is to prescribe the penalties for failure to respond to Division of Insurance inquiries within the timeframes specified in this regulation.

Section 3 Applicability And Scope

This regulation shall apply to all persons and entities over whom the Division of Insurance has authority, including, but not limited to, producers, insurers, health maintenance organizations and insurance agencies for all lines of insurance. This regulation does not apply where a different timeframe for responding to Division of Insurance inquiries or providing documentation or information is specifically established by Colorado statute or Division of Insurance regulation.

Section 4 Definitions: As used in this regulation:

- A. "Division" shall mean the Colorado Division of Insurance.
- B. "Incomplete response" shall mean a response that does not substantially address the inquiry, as determined by the Division.
- C. "Inquiry" shall mean any written Division request to any person, for documents, information or an explanation or response. Inquiry includes, but is not limited to, market conduct examination comment forms, financial examination request forms, and information requests arising from complaints received by the Division.
- D. "Examination Request/Comment Form" means a request for information made during the course of a formal market conduct or financial examination under §§ 10-1-201 to 207, C.R.S., and includes:
 - 1) A written request from the examiner for books, records, materials, information, or data necessary for examination of the company's operations; and
 - 2) A written comment from the examiner which identifies concerns related to company actions and requires additional information or acknowledgment from the company.
- E. "Person" shall have the same meaning as in § 10-2-103(8), C.R.S.
- F. "Response" means all written information provided to the Division from the person to whom the inquiry is made.

Section 5 Rules

A. Unless another time period is specified by the Division in writing, every person shall provide a complete response to Examination Request/Comment Forms within ten (10) calendar days from the date on the form.

B. Except for responses to Examination Request/Comment Forms, and unless another time period is specified by statute, regulation or by the Division in writing, every person shall provide a complete response in writing to any inquiry from the Division within thirty (30) calendar days from the date of the inquiry.

C. If additional time is required to respond to any Division inquiry, the person shall submit a request for an extension of time in writing to the Division employee or examiner making the inquiry. The request for an extension of time shall be made within the original response period established in this regulation, and shall state in detail the reasons necessitating the extension. Extensions are granted at the discretion of the Division for good cause shown. When a request for extension is granted, the person shall respond within the new time period granted. If an extension is not granted, the person shall respond within ten (10) calendar days of the notice that the extension was not granted, and is subject to the imposition of appropriate penalties from the original due date.

D. The Division will calculate the applicable time periods from the date of the correspondence from the Division to: 1) if the response is mailed, the postmark date on the response; 2) if the response is hand-delivered to the Division's offices, the date identified by the Division's date received stamp; 3) if the response is hand-delivered directly to Division staff, Division representatives or examiners off of Division premises, the date the staff, representative or examiner receives the response as acknowledged by the staff, representative or examiner; 4) if the response is transmitted electronically, the electronically recorded date; and 5) if the response is faxed, the date shown on the fax transmission sheet.

E. Failure to provide a response, or providing an incomplete response to Division inquiries at any point in the handling of a matter, including during the course of a financial or market conduct examination, subjects the person to immediate imposition of a minimum \$500 fine per act or occurrence.

Section 6 Enforcement:

Noncompliance with the requirements and timeframes specified in this regulation may result, after proper notice and hearing, in the imposition of any sanctions made available in Colorado statutes pertaining to the business of insurance or other laws which include the imposition of fines, issuance of cease and desist orders, and/or suspension or revocation of license.

During the course of the review, various attempts were made to obtain a detailed list of claims from the Company. Due to the fact this information needed to be gathered from Third Party Administrators at various locations, delays were experienced in producing the information which resulted in the failure to provide the requested claim documents in a timely manner.

In addition, the Company's Third Party Administrators failed to provide the audit worksheets and/or billing statements in the following number of policy files sampled for examination. After a comment form was issued to the Company, the Third Party Administrators located many of the missing documents. However, they were not received by the examiners until July 11, 2005, which was too late to include in the examination review. This resulted in an incomplete billing comparison review of the Unit Statistical Reports and an inability to ascertain if factors such as audit and/or billing premiums, classifications and experience modifications were correct.

The following charts illustrate the significance of errors versus the population and sample examined:

**Workers' Compensation Policies with Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
326	50	6	12%

An examination of fifty (50) policies with experience modifiers, representing 15% of all workers' compensation policies with experience modifiers which contain Colorado exposures written by the Company during the period July 1, 2002 to December 31, 2003, showed six (6) policies in which the files did not contain the requested audit worksheets and/or billing statements.

**Workers' Compensation Policies without Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
502	50	41	82%

An examination of fifty (50) policies with experience modifiers, representing 10% of all workers' compensation policies with experience modifiers which contain Colorado exposures written by the Company during the period July 1, 2002 to December 31, 2003, showed forty-one (41) policy files in which the files did not contain the requested audit worksheets and/or billing statements.

**Workers' Compensation Policies with 2004 Inception Dates
From January 1, 2004-December 31, 2004**

Population	Sample Size	Number of Exceptions	Percentage to Sample
30	30	30	100%

An examination of thirty (30) policies with 2004 inception dates, representing 100% of all workers' compensation policies which contained Colorado exposures written by the Company during 2004, showed thirty (30) policy files in which the files did not contain the requested audit worksheets and/or billing statements.

Recommendation Number 2:

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Regulation 1-1-8. If the Company is unable to provide such documentation, it should be required to provide written evidence to the Colorado Division of Insurance that it will correct its procedures in order to be able to provide documents in a timely manner for future examinations when writing workers' compensation policies containing Colorado exposures.

UNDERWRITING AND RATING
PERTINENT FACTUAL FINDINGS

Issue C: Failure of the Company to provide the insured with a form to indicate their awareness of the premium differential available when an insured selects a cost containment option and a designated medical provider, and to retain this form in the insured's underwriting file.

Colorado Regulation 5-1-11, Risk Modification Plans, promulgated pursuant to the authority of Section 10-1-109, 10-4-401, 10-4-403, 10-4-404, and 10-4-408, C.R.S., states, in part:

(III) RULES...

(D) Workers' Compensation Cost Containment Disclosures

All workers' compensation insurers, including the Colorado Compensation Insurance Authority, shall disclose the availability of cost containment certification by the Colorado Workers' Compensation Cost Containment Board and the potential premium savings on the face of the insurance policy or in a separate disclosure form attached as an addendum to the policy. Such disclosure applies regardless of whether or not a risk is experience or schedule rated. *Insurers shall require that the insured business entity indicate* [emphasis added] on a form developed by the insurer, which states that the business entity is aware of the premium dividend if the business entity's risk management program is certified by the Colorado Cost Containment Board. *This form shall be made part of the insured business entity's underwriting file.* [Emphasis added]

On an annual basis, all workers' compensation insurers, including the Colorado Compensation Insurance Authority, shall disclose the premium differential on the face of the insurance policy or in a separate disclosure form attached as an addendum to the policy when the policyholder has selected a designated medical provider. Such disclosure applies regardless of whether a risk is experience rated or schedule rated. *Insurers shall require that the insured business entity indicate* [emphasis added] on a form developed by the insurer, which states that the business entity is aware of the premium differential for selecting a designated medical provider. *This form shall be made part of the insured business entity's underwriting file.* [Emphasis added]

The following charts illustrate the significance of errors versus the populations and samples examined:

**Workers' Compensation Policies with Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
326	50	50	100%

An examination of fifty (50) policies with experience modifiers, representing 15% of all workers' compensation policies with experience modifiers, written by the Company during the period July 1, 2002 to December 31, 2003, showed fifty (50) exceptions (or 100% of the sample) in which there were no signed forms in the underwriting file, which, insureds could have indicated their awareness of the premium differential available if they had chosen a medical cost containment option and if they had selected a designated medical provider.

**Workers' Compensation Policies without Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
502	50	50	100%

An examination of fifty (50) policies without experience modifiers, representing 10% of all workers' compensation policies without experience modifiers, written by the Company during the period July 1, 2002 to December 31, 2003, showed fifty (50) files (or 100% of the sample) in which there were no signed forms in the underwriting file, which, insureds could have indicated their awareness of the premium differential available if they had chosen a medical cost containment option and if they had selected a designated medical provider.

**Workers' Compensation Policies
January 1, 2004 to December 31, 2004**

Population	Sample Size	Number of Exceptions	Percentage to Sample
30	30	30	100%

An examination of thirty (30) policies, representing 100% of all workers' compensation policies without experience modifiers, written by the Company during the period January 1, 2004 to December 31, 2004, showed thirty (30) files (or 100% of the sample) in which there were no signed forms in the underwriting file, which, insureds could have indicated their awareness of the premium differential available if they had chosen a medical cost containment option and if they had selected a designated medical provider.

Recommendation Number 3:

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Colorado Regulation 5-1-11. In the event the Company is unable to provide such documentation, it should be required to provide written procedures to the Colorado Division of Insurance which will ensure that the Company will retain a copy of a form in an insured's underwriting file, on which, the insured has indicated their awareness of the premium differential available, if they were to choose a medical cost containment option and if they had selected a designated medical provider, in compliance with Colorado insurance laws.

Issue D: Failure of the Company, in some cases, to apply the correct rating methodology when rating workers' compensation policies which contain Colorado exposures.

Section 10-4-401, C.R.S., Purpose – applicability, states, in part:

(3) The kinds of insurance subject to this part 4 shall be divided into two classes, as follows...

(b) Type II kinds of insurance, regulated by open competition between insurers, including fire, casualty, inland marine, title insurance, and all other kinds of insurance subject to this part 4 and not specified in paragraph (a) of this subsection (3), including the expense and profit components of workers' compensation insurance, which shall be subject to all the provisions of this part 4 except for sections 10-4-405 and 10-4-406. Concurrent with the effective date of new rates, type II insurers shall file rating data, as provided in section 10-4-403, with the commissioner.

Additionally, Section 10-3-1104, C.R.S., Unfair methods of competition and unfair or deceptive acts or practices, states, in part:

(1) The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance...

(f)(II) Making or permitting any unfair discrimination between individuals of the same class or between neighborhoods within a municipality and of essentially the same hazard in the amount of premium, policy fees, or rates, charged for any policy or contract of insurance, or in the benefits payable thereunder, or in any of the terms or conditions of such contract, or in any other manner whatever;

Regulation 5-1-10, Rate and Rule Submissions Property and Casualty Insurance, promulgated pursuant to the authority of Sections 10-1-109, 10-3-1110, 10-4-404, and 10-4-404.5, C.R.S., states, in part:

Section 5. Rules...

C. Rule Filing General Requirements...

2. Every property and casualty company, including those writing workers' compensation and title insurance, is required by this regulation to provide a list of minimum premiums, schedule of rates, rating plans, dividend plans, individual risk modification plans, deductible plans, rating classifications, territories, rating rules, rate manuals and every modification of any of the foregoing which it proposes to use. Such filings must state the proposed effective date thereof, and indicate the character and extent of the coverage contemplated.

The following chart illustrates the significance of errors versus the population and sample examined:

**Workers' Compensation Policies with Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
326	50	1	2%

An examination of fifty (50) policies with experience modifiers, representing 15% of all workers' compensation policies with experience modifiers which contain Colorado exposures, written by the Company during the period July 1, 2002 to December 31, 2003, showed one (1) exception in which incorrect rating methodology was used. The error resulted from an incorrect calculation of chargeable payroll when a month was subtracted instead of being added to the calculation. This error resulted in an undercharge of \$625.

**Workers' Compensation Policies without Experience Modifiers
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
502	50	3	6%

An examination of fifty (50) policies without experience modifiers, representing 10% of all workers' compensation policies without experience modifiers which contain Colorado exposures, written by the Company during the period July 1, 2002 to December 31, 2003, showed three (3) exceptions (or 6% of the sample) in which incorrect rating methodology was used. All three (3) exceptions involved an error of the governing classification. Two (2) insureds were video stores that had been classified as 8017, Retail Stores, when code 8072 (Book, Record, Video-Retail) applied. One classification error resulted in no difference in premium because the rates were the same at that time and the other classification error resulted in an overcharge of \$90, which should be refunded to the insured. The remaining error was an insured operating a coffee shop that had been classified as a retail store (8017) instead of a restaurant (9083). This error resulted in an undercharge of \$161.00.

**Workers' Compensation Policies
January 1, 2004-December 31, 2004**

Population	Sample Size	Number of Exceptions	Percentage to Sample
30	30	1	3%

An examination of thirty (30) files representing 100% of all workers' compensation policies written by the company in 2004, showed one (1) exception or 3% of the sample in which a relative of the owner of the business was not included in the premium charged even though the individual was included in the payroll records. When an individual is included in the payroll records of an insured entity, they are covered by the policy. There are no provisions in Colorado workers' compensation law for excluding a relative of an owner that is on the payroll.

Recommendation Number 4:

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Sections 10-4-401, 10-3-1104, C.R.S, and Colorado Regulation 5-1-10. If the Company is unable to provide such documentation, it should be required to provide written evidence to the Colorado Division of Insurance that it has taken the appropriate steps to ensure that it will apply correct rating methodology when rating policies with Colorado exposures in compliance with Colorado insurance laws.

Issue E: Failure of the Company, in some cases, to audit insureds' records in order to calculate a correct earned premium for cancelled policies

Section 10-4-401, C.R.S., Purpose – applicability, states, in part:

(3) The kinds of insurance subject to this part 4 shall be divided into two classes, as follows...

(b) Type II kinds of insurance, regulated by open competition between insurers, including fire, casualty, inland marine, title insurance, and all other kinds of insurance subject to this part 4 and not specified in paragraph (a) of this subsection (3), including the expense and profit components of workers' compensation insurance, which shall be subject to all the provisions of this part 4 except for sections 10-4-405 and 10-4-406. Concurrent with the effective date of new rates, type II insurers shall file rating data, as provided in section 10-4-403, with the commissioner.

Additionally, Section 10-3-1104, C.R.S., Unfair methods of competition and unfair or deceptive acts or practices, states, in part:

(2) The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance...

(f)(II) Making or permitting any unfair discrimination between individuals of the same class or between neighborhoods within a municipality and of essentially the same hazard in the amount of premium, policy fees, or rates, charged for any policy or contract of insurance, or in the benefits payable thereunder, or in any of the terms or conditions of such contract, or in any other manner whatever;

Regulation 5-1-10, Rate and Rule Submissions Property and Casualty Insurance, promulgated pursuant to the authority of Sections 10-1-109, 10-3-1110, 10-4-404, and 10-4-404.5, C.R.S., states, in part:

Section 5. Rules...

C. Rule Filing General Requirements...

2. Every property and casualty company, including those writing workers' compensation and title insurance, is required by this regulation to provide a list of minimum premiums, schedule of rates, rating plans, dividend plans, individual risk modification plans, deductible plans, rating classifications, territories, rating rules, rate manuals and every modification of any of the foregoing which it proposes to use. Such filings must state the proposed effective date thereof, and indicate the character and extent of the coverage contemplated.

3. Companies may adopt, by reference, rating and/or advisory organization insurance rating plans, individual risk modification plans, deductible plans, rating classifications, territories, rating rules, rate manuals, and modifications of any of the foregoing. A completed copy of the appropriate filing form prescribed by the Commissioner in a separate Bulletin must accompany the filing.

NCCI Basic Manual Rules: Rule 3-A-13 states in part:

13. Final Earned Premium

Final Earned Premium is the total premium earned during the policy term. It is calculated using actual payrolls multiplied by the rate for each classification. Final earned premium includes the application of premium elements applicable to the insured.

Final earned premium for the policy must be determined on *actual payroll as determined by the carrier at audit*, instead of on estimated payroll or other premium basis. [Emphasis added]

Determination of final earned premium is governed by the rules, classifications, and rates in this manual, subject to modification by applicable rating plans...

The following chart illustrate the significance of errors versus the populations and samples examined:

**Cancelled Workers' Compensation Policies
From July 1, 2002-December 31, 2003**

Population	Sample Size	Number of Exceptions	Percentage to Sample
227	50	18	36%

An examination of fifty (50) cancelled policies, representing 22% of all cancelled workers' compensation policies, written by the Company during the period July 1, 2002 to December 31, 2004, showed eighteen (18) policies in which the Company did not perform an audit which would have determined the actual earned premium instead of the estimated premium charged at inception.

Recommendation Number 5:

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Sections 10-4-401 and 10-3-1104, and Colorado Regulation 5-1-10. In the event the Company is unable to provide such documentation, it should be required to provide written procedures to the Colorado Division of Insurance which will ensure that the Company will perform audits in order to charge the actual premium instead of estimated premium in compliance with Colorado insurance laws.

Issue F: Failure of the Company, in some cases, to clearly and conspicuously inform the policyholders of the availability of the deductible options as specified in the NCCI Colorado manual rules.

Section 10-4-401, C.R.S., Purpose - applicability, states, in part:

(3) The kinds of insurance subject to this part 4 shall be divided into two classes, as follows...

(b) Type II kinds of insurance, regulated by open competition between insurers, including fire, casualty, inland marine, title insurance, and all other kinds of insurance subject to this part 4 and not specified in paragraph (a) of this subsection (3), including the expense and profit components of workers' compensation insurance, which shall be subject to all the provisions of this part 4 except for sections 10-4-405 and 10-4-406. Concurrent with the effective date of new rates, type II insurers shall file rating data, as provided in section 10-4-403, with the commissioner.

Additionally, Section 10-3-1104, C.R.S., Unfair methods of competition and unfair or deceptive acts or practices, states, in part:

(1) The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance. . .

(f)(II) Making or permitting any unfair discrimination between individuals of the same class or between neighborhoods within a municipality and of essentially the same hazard in the amount of premium, policy fees, or rates, charged for any policy or contract of insurance, or in the benefits payable thereunder, or in any of the terms or conditions of such contract, or in any other manner whatever;

Regulation 5-1-10, Rate and Rule Submissions Property and Casualty Insurance, promulgated pursuant to the authority of Sections 10-1-109, 10-3-1110, 10-4-404, and 10-4-404.5, C.R.S., states, in part:

Section 5. Rules...

C. Rule Filing General Requirements...

2. Every property and casualty company, including those writing workers' compensation and title insurance, is required by this regulation to provide a list of minimum premiums, schedule of rates, rating plans, dividend plans, individual risk modification plans, deductible plans, rating classifications, territories, rating rules, rate manuals and every modification of any of the foregoing which it proposes to use. Such filings must state the proposed effective date thereof, and indicate the character and extent of the coverage contemplated.

NCCI Basic Manual Rules, 2001 Edition, (Colorado), which was filed on behalf of Clarendon National Insurance Company, states in part:

Basic Manual—2001 Edition—COLORADO**DEDUCTIBLE INSURANCE**

Each insurer transacting or offering to transact workers compensation insurance in Colorado shall offer deductibles to employers who request such coverages and who are sufficiently financially stable to be responsible for the payment of the deductible amounts. Insurers may also offer medical and indemnity deductibles to employers

Deductible coverage is effected by attaching the Benefits Deductible Endorsement to the policy. *Every insurance carrier shall clearly and conspicuously inform policyholders of the availability of the deductible option specified below.* [Emphasis added]

Deductibles shall be available for medical and indemnity benefits in amounts of \$500, \$1,000, \$1,500, \$2,000, \$2,500 and \$5,000 per claim. The deductible shall apply separately to each claim for bodily injury by accident or disease.

The claim shall be paid by the insurer, which shall then be reimbursed by the employer for any deductible amounts paid by the insurer. The employer shall be liable for reimbursement up to the limit of the deductible chosen. The payment or nonpayment of deductible amounts by the insured employer to the insurer shall be treated under the policy insuring the liability for workers compensation in the same manner as payment or nonpayment of premiums.

An insurer shall not be required to offer a deductible to an employer if, as a result of a credit investigation, the insurer determines that the employer is not sufficiently financially stable to be responsible for the payment of the deductible amounts.

The applicable premium reduction percentage is that percentage corresponding to the appropriate hazard group and the desired deductible amount. The premium reduction for deductible coverage is obtained by the application of the appropriate premium reduction percentage to the premium determined before application of any experience or schedule modification, merit rating, premium discounts or any retrospective rating plans.

Policies in the three categories totaled one hundred thirty (130) policies. One hundred twenty-eight (128) policy files (98.5%) failed to show documentation that policyholders were clearly and conspicuously informed of the availability of the deductible option as described above.

Recommendation Number 6:

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Sections 10-4-401 and 10-3-1104, C.R.S., and Colorado Insurance Regulation 5-1-10. In the event the Company is unable to provide such documentation, it should be required to provide written procedures to the Colorado Division of Insurance which will ensure that the Company will clearly and conspicuously inform policyholders of the availability of the deductible options as specified in the NCCI Colorado Manual Rules in compliance with Colorado insurance laws.

SUMMARY OF RECOMMENDATIONS

<u>ISSUE</u>	<u>RECOMMENDATION NUMBER</u>	<u>PAGE NUMBER</u>
Company Operations and Management		
Issue A: Failure of the Company, in some cases, to maintain records required when writing workers' compensation policies which contain Colorado exposures.	1	15
Issue B: Failure of the Company, in some cases, to provide documents in a timely manner to complete the review of workers' compensation claims payments, reserves, audit worksheets and billing statements in order to compare to the Unit Statistical Reports and ascertain correctness of billing factors.	2	19
Underwriting		
Issue C: Failure of the Company to require the insured to indicate on a form their awareness of the premium differential available when an insured selects a medical cost containment option and a designated medical provider and to retain this form in the insured's underwriting file.	3	22
Issue D: Failure of the Company, in some cases, to apply the correct rating methodology when rating workers' compensation policies which contain Colorado exposures.	4	25
Issue E: Failure of the Company, in some cases, to audit the insured's records in order to calculate a correct earned premium for the Workers' Compensation Policy.	5	27
Issue F: Failure of the Company, in some cases, to clearly and conspicuously inform the policyholders of the availability of the deductible options as specified in the NCCI Colorado manual rules.	6	29

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Participated in this examination and in the preparation of this report